REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE MOQHAKA LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Moqhaka Local Municipality which comprise the statement of financial position as at 30 June 2008, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages [xx] to [xx].

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy notes 1 to 21 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007 (DoRA). This responsibility includes:

   - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
   - selecting and applying appropriate accounting policies
   - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and Section 126 of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

4. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy notes 1 to 21.

Basis for disclaimer of opinion

Net assets

5. Audit assurance as to the existence, valuation and completeness of reserves amounting to R528 031 062 in the current year and R493 661 928 in the previous year, as set out in the statement in changes in net assets, could not be obtained due to the following:

a) As disclosed in note 9.1 to the financial statements, on the implementation of Statements of Generally Accepted Municipal Accounting Practice (GAMAP) and Statements of Generally Recognised Accounting Practice (GRAP), the balance on certain funds, created in terms of the Provincial Ordinance applicable at the time, that had historically been utilised for the acquisition of items of property, plant and equipment, have been transferred to a capitalisation reserve instead of the accumulated surplus/(deficit) in terms of a directive issued by National Treasury. The balance on the capitalisation reserve equals the carrying

value of the items of property, plant and equipment financed from the former legislated funds. When items of property, plant and equipment are depreciated, a transfer is made from the capitalisation reserve to the accumulated surplus/(deficit). Sufficient information was not available to determine the method of financing items of property, plant and equipment purchased and the carrying value of property, plant and equipment financed by former legislated funds. I was further unable to perform any alternative procedures.

b) As disclosed in note 9.2 to the financial statements, when items of property, plant and equipment are financed from government grants, a transfer is made from the accumulated surplus/(deficit) to the Government Grants Reserve equal to the government grant recorded as revenue in the Statement of Financial Performance in accordance with a directive issued by National Treasury. When such items of property, plant and equipment are depreciated, a transfer is made from the Government Grant Reserve to the accumulated surplus/(deficit). Sufficient information was not available to determine the method of financing items of property, plant and equipment purchased, and the carrying value of property, plant and equipment financed by government grants according to the fixed asset register exceeded the government grant reserve by R47 106 835 in the previous year. In addition, no revenue from government grants was transferred from the accumulated surplus to the government grant reserve in the statement of changes in net assets. I was further unable to perform any alternative procedures.

c) As disclosed in note 9.3 to the financial statements, in order to finance the provision of infrastructure and other items of property, plant and equipment from internal sources, amounts are transferred from the accumulated surplus/(deficit) to the capital replacement reserve. A corresponding amount is transferred to a designated capital replacement reserve bank or investment account. Sufficient information was not available to determine the method of financing items of property, plant and equipment purchased and a designated capital replacement reserve bank or investment account has not been opened. No amounts pertaining to the cost of items of property, plant and equipment were transferred to the accumulated surplus in the general ledger and statement of changes in net assets from the capital replacement reserve, in the previous year. I was further unable to perform any alternative procedures.

d) Paragraph 110 of the Statements of Generally Recognised Accounting Practice (GRAP) Presentation of Financial Statements (GRAP 1) states that an entity shall present a statement of changes in net assets, showing on the face of the statement the surplus or deficit for the period. The amount of the accumulated deficit for the 2004-05 financial year in the statement of changes in net assets was incorrectly recorded and did not agree with the comparative deficit as per the income statement. The income statement for the 2004-05 financial year indicated a deficit of R17 273 651 while the statement of changes in net assets reflected a deficit of R42 559 550. Sufficient appropriate audit evidence could still not be obtained for this difference amounting to R25 285 899. This matter was also reported in the previous year.

e) As disclosed in prior period error notes 27.26 and 27.27 to the financial statements, errors amounting to R572 420 and R410 629 respectively were discovered in the previous year's financial statements relating to funeral assistance and other payables. Funeral assistance was incorrectly classified as accumulated surplus and no interest was provided on other payables. Sufficient appropriate audit evidence could not be obtained to substantiate the accuracy of these corrections. Alternative procedures could also not be performed and therefore no assurance could be obtained that these prior period errors were accurately and completely adjusted and presented in the financial statements.

Property, plant and equipment

6. The fixed asset register was incomplete and did not contain information to confirm depreciation, carrying value and condition of the fixed assets. No periodic fixed asset counts were conducted and fixed assets according to the fixed asset register differed from the general ledger by R201 669 069 in the current year and by R46 350 586 in the previous year. Audit assurance as to the completeness, existence, rights of ownership and valuation of plant and equipment amounting to R524 210 968 in the current year and R482 026 092 in the previous year, as disclosed in note 1 to the financial statements, could not be obtained and alternative procedures could also not be performed.

7. Property, plant and equipment amounting to R524 210 968 in the current year and R482 026 092 in the previous year, as disclosed in note 1 to the financial statements, were not accurately valued and completely accounted for due to the following:

a) Paragraph 40 of the Statement of Generally Accepted Municipal Accounting Practice (GAMAP) *Property, Plant and Equipment* (GAMAP 17) states that subsequent to initial recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses. Inadequate depreciation was written off on property, plant and equipment as a result of a decision taken by management at the start of the 2006 financial year. The municipality selectively complied with certain requirements of GAMAP 17 and did not calculate and provide for adequate depreciation of their property, plant and equipment. As indicated above, the asset register did not contain sufficient information to calculate depreciation. Depreciation and accumulated depreciation were therefore understated by an unknown amount. This matter was also reported in the previous year.

b) Paragraph 15 of GAMAP 17 states that in certain circumstances, it is appropriate to allocate the total expenditure on an asset to its component parts and account for each component separately. This is the case when the component assets have different useful lives or provide benefits to the entity in a different pattern, thus necessitating the use of different depreciation rates and methods. Evidence that the council had evaluated the fixed assets to determine whether a part of an item of property, plant and equipment was significant in relation to the total cost of the item could not be obtained. Depreciation and accumulated depreciation were therefore misstated by an unknown amount. This matter was also reported in the previous year.

c) Paragraph 6 of GAMAP 17 states that an item of property, plant and equipment should be recognised as an asset when:

(a) it is probable that future economic benefits or service potential associated with the asset will flow to the entity, and

(b) the cost or fair value of the asset to the entity can be measured reliably.

Capital costs amounting to R1 914 959 in the previous year were included in the comparative information as general expenditure in the statement of financial performance and were not capitalised in the previous financial year. Furthermore, asset additions to the value of R68 961 in the current year and R597 546 in the previous year were expensed as repairs and maintenance and not recognised as assets as required by GAMAP 17. This matter was also reported in the previous year.

d) Paragraph 31 of the South African Statement of Generally Accepted Accounting Practice IAS 17 (AC 105) Leases states that lessees shall disclose the net carrying amount at balance sheet date for each finance lease asset. The financial statements did not disclose the net carrying amount at balance sheet date for finance lease assets. As indicated above, no updated fixed asset register was available at year-end and inadequate depreciation was written off on property, plant and equipment. Alternative procedures could also not be performed and therefore I could not calculate the carrying amount of leased assets. The financial impact of this matter could not be determined.

Employee-related costs

8. Audit assurance as to the accuracy, completeness and occurrence of employee related costs to the value of R89 025 906 for the previous year could not be obtained due to the following:

a) Employee files and signed employment contracts could not be presented for employee-related costs amounting to R4 031 750 and R1 764 371, respectively, relating to the previous year. Alternative procedures could also not be performed and therefore no assurance could be obtained that these costs had actually occurred and were accurately recorded.

b) Occurrence of employee-related costs amounting to R5 273 468 relating to the previous year could not be obtained as the existence of employees could not be physically verified or confirmed through alternative procedures.

Receivables

9. Audit assurance as to the existence, valuation and completeness of consumer receivables amounting to R37 877 959 in the current year and R46 825 362 in the previous year, and other receivables amounting to R102 489 492 in the current year and R78 397 339 in the previous year, could not be obtained due to the following:

a) Sufficient appropriate audit evidence could not be obtained on the valuation of consumer receivables amounting to R236 727 in the current year and R167 389 in the previous year, as presented in note 5 to the financial statements. In addition, sufficient appropriate audit evidence could not be obtained for government subsidies and other receivables, as disclosed in note 6 to the financial statements in the current year, amounting to R1 750 769 and R7 809 683 respectively, and sundry receivables amounting to R6 778 253 in the previous year, as presented in note 6 to the financial statements. I was further unable to perform alternative procedures.

b) Included in the system-generated debtor age analysis were consumer receivables, other receivables and payments received in advance, amounting to R109 919 424, R76 273 020 and R16 694 219 respectively. These balances, however, exceed the debtor age analysis by R1 056 233 in the current year and by R740 030 in the previous year. Sufficient appropriate audit evidence could not be obtained for this difference or through alternative procedures. This matter was also reported in the previous year.

c) No supporting documentation could be obtained for journals amounting to R2 399 996 in respect of bad debt written off in the previous year nor could audit assurance be obtained through performance of alternative procedures

10. Consumer debtors amounting to R37 877 959 in the current year and R46 825 362 in the previous year, and other debtors amounting to R102 489 492 in the current year and R78 397 339 in the previous year, were not accurately valued and completely accounted for due to the following inconsistencies identified:

a) Paragraph 46(a) of the South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC 133): *Financial Instruments: Recognition and Measurement* (IAS 39) states that after initial recognition, an entity shall measure loans and receivables at amortised cost using the effective interest method. Interest on receivables as presented in note 6 to the financial statements amounting to R38 523 996 in the current year and R35 175 364 in the previous year was incorrectly included as other receivables. In addition, VAT on consumer receivables amounting to R12 482 427 in the current year, is incorrectly included in note 6 to the financial statements as sundry receivables. Consequently, other receivables was overstated and consumer receivables understated by R51 006 423 in the current year and R35 175 364 in the previous year.

b) Paragraph 63 of IAS 39 states that if there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. Based on the recoverability of previous debtors, the provision for bad debts, as disclosed in note 5 to the financial statements, and accumulated surplus were understated by R24 018 253 in the current year and R35 258 646 in the previous year. The actual amount of bad debt written off exceeded the amount approved by council by R7 536 463 in the previous year. In addition, bad debts according to the statement of financial performance exceeded the general ledger by R950 000 and no supporting documentation could be presented for bad debts written off amounting to R114 224 in the current year, as disclosed in note 5 to the financial statements.

c) Uncleared suspense accounts of R17 272 952 in the current year and R1 673 840 in the previous year were included in other receivables as disclosed in note 6 to the financial statements.. Income, expenditure and additions to property, plant and equipment amounting to R400 179, R4 330 563 (R1 059 801 in the previous year) and R1 734 554 respectively, were included in unallocated amounts. Income, expenditure and property, plant and equipment were therefore understated and other receivables overstated by these amounts.

d) Paragraph 6 of GAMAP 17 states that an item of property, plant and equipment should be recognised as an asset when:

(a) it is probable that future economic benefits or service potential associated with the asset will flow to the entity, and

(b) the cost or fair value of the asset to the entity can be measured reliably.

Capital expenditure amounting to R2 958 560 was incorrectly included in sundry receivables as disclosed in note 6 to the financial statements in the previous year and in unallocated amounts in the current year. Therefore, property, plant and equipment was understated and other receivables overstated by this amount in the previous year and current year.

e) Paragraph 42 of the Statement of Generally Recognised Accounting Practice *Presentation of Financial Statements* (GRAP 1) states that assets and liabilities, and income and expenses, shall not be offset unless required or permitted by a Standard of GRAP. Bad debts and revenue as presented in the statement of financial performance were understated by R1 149 552 in the previous year. These bad debt expenses were incorrectly offset in the income accounts to which they relate in the previous year. This matter was also reported in the previous year.

Revenue

11. Sufficient appropriate audit evidence as to the completeness and accuracy of assessment rates levied to the amount of R30 482 515 in the previous year could not be obtained. No reconciliations between rateable valuation as per the valuation roll and assessment rates levied through the Venus system were performed for July, August and September 2006. The municipality's records did not permit the application of alternative audit procedures regarding assessment rates.

12. Due to the lack of sufficient appropriate audit evidence, the occurrence, accuracy and completeness of interest amounting to R5 113 556 that was charged for outstanding debtor accounts in the previous year, could not be obtained. The accounting system of the municipality did not permit the application of alternative audit procedures.

13. The municipality did not keep a direct income register and the municipality's accounting system did not permit me to perform any alternative procedures. Therefore, audit assurance

as to the completeness and accuracy of other income amounting to R2 403 360 in the previous year could not be obtained.

14. Sufficient appropriate audit evidence could not be presented as to the accuracy and completeness of rental of facilities and equipment revenue amounting to R2 687 921 in the current year and R2 613 040 in the previous year, as disclosed in the statement of financial performance, as no rental register was maintained. I could furthermore not perform alternative procedures.

15. Paragraph 6 of GRAP 1 states that revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets, other than increases relating to contributions from owners. Internally generated income and expenditure were not eliminated with the preparation of the financial statements. This resulted in the overstatement of service charges and general expenses by R1 526 485, as presented in the statement of financial performance.

16. No supporting documentation or information could be obtained for rental income for the previous year amounting to R480 391 as included in note 21 to the financial statements. The municipality's accounting system did not permit me to perform any alternative procedures and I could therefore satisfy myself as to the occurrence and accuracy of this income.

17. Paragraph 115 of GRAP 1 states that all items of revenue and expense recognised in a period should be included in the surplus or deficit for the period unless another Standard of GRAP requires otherwise. An amount of R10 994 877 in the current year and R10 860 836 in the previous year relating to assessment rates were erroneously deducted from general expenses. This resulted in an understatement of expenditure and revenue in the current and previous years.

Payables

18. Audit assurance could not be obtained as to the existence, valuation and completeness of accounts payable amounting to R79 918 721 in the current year and R61 609 565 in the previous year, due to the following:

a) Sufficient appropriate audit evidence could not be presented to enable me to obtain audit assurance on the valuation and existence of payments received in advance as presented in note 14 to the financial statements amounting to R7 913 657 in the current year and R9 649 040 in the previous year. In addition, payments received in advance as per note 14 to the financial statements exceeded the age analysis of debtors with credit balances in the previous year by R677 622. The accounting system of the municipality did not permit the application of alternative audit procedures.

b) Sufficient appropriate audit evidence could not be presented for other payables amounting to R19 543 818 in the previous year and unallocated amounts amounting to R1 521 996 in the current year. The municipality's accounting system did not permit the application of alternative audit procedures. Therefore, no assurance could be obtained that other payables amounting to R29 323 278 in the previous year and unallocated amounts amounting to R9 313 423 in the current year, included in note 14 to the financial statements, actually existed and have been accurately valued.

c) Sufficient appropriate audit evidence could not be presented for the accumulated leave provision as presented in note 14 to the financial statements amounting to R1 718 857 in the current year and R1 521 910 in the previous year. In a number of instances annual leave was approved after it had been taken. Certain leave records could not be presented and the municipality did not have adequate leave registers and therefore alternative procedures could not be performed. Therefore no assurance could be obtained that these balances actually existed and have been accurately valued.

19. Accounts payable amounting to R79 918 721 in the current year and R61 609 565 in the previous year did not represent amounts owed and were not accurately valued in the following instances:

a) Suspense accounts were not cleared regularly and before the preparation of the financial statements. Consequently, unallocated amounts amounting to R9 313 423 in the current year and R4 831 747 in the previous year were disclosed as payables in note 14 to the financial statements. Income relating to the previous year amounting to R5 318 478 and expenditure for the current and previous year amounting to R153 940 and R203 614, respectively, were identified that have been disclosed as unallocated amounts. Furthermore, in an attempt to clear a suspense account relating to output tax on prepaid electricity raised by the South African Revenue Services (SARS) as a result of a VAT audit, a journal was incorrectly recognised which resulted in unallocated amounts being overstated and accumulated surplus being understated by R1 404 621. Accumulated surplus and expenditure are therefore understated by R6 519 485 and R153 940, respectively, and other payables overstated by R6 365 545.

b) An amount of R8 146 418 was included in the current and corresponding figure of other payables as disclosed in note 14 to the financial statements, which represented indigent receivables written off, as resolved in a council meeting. This amount is therefore incorrectly classified as other payables and should have been offset against consumer receivables. As a result, consumer receivables and other payables were overstated by R8 146 418.

Expenditure

20. Tender documents to the value of R12 094 916 could not be provided in the previous year. In addition, no supporting documentation or information could be presented for system-generated journals amounting to R4 526 656 and credit card payments to the value of R125 695 in the previous year. I was furthermore not able to perform alternative procedures. Therefore, the occurrence and accuracy of expenditure as disclosed in the statement of financial performance could not be confirmed.

Value-added tax

21. Audit assurance as to the existence, valuation and completeness of VAT payable amounting to R11 619 362 in the current year and R13 725 844 in the previous year could not be obtained and I was unable to perform alternative procedures due to the following:

a) An amount of R4 005 583 was claimed in the previous year pertaining to input tax not claimed in the previous periods. The accuracy and completeness of this amount could not be confirmed.

b) No supporting documentation or information could be presented in the previous year for an overpayment of VAT amounting to R1 116 058 in September 2006. The accuracy and completeness of this amount could not be confirmed.

Unspent conditional grants and receipts

22. Paragraph 43(c) of the Statement of Generally Accepted Municipal Accounting Practice (GAMAP 9) *Revenue* states that government grants are recognised as revenue to the extent that there has been compliance with any restrictions associated with the grant. Unspent conditional grants and receipts, as disclosed in note 15 to the financial statements, as well as government grants and subsidies revenue, as disclosed in note 20 to the financial statements, were not accurate and completely accounted for as no portion of the institutional, restructuring or Municipal Infrastructure Grant (MIG) received amounting to R734 000, R500 000 and R21 229 729, respectively, were recognised and disclosed as revenue in the previous year. I could not determine the extent to which there has been compliance with the conditions of these grants and to what extend the receipts should have been recognised as

income in the current and previous year as registers were not maintained for the spending of the institutional and restructuring grants. Although a register was maintained for the MIG, the balance recorded in the financial statements exceeded the register by R 5 138 468 in the current year and R759 319 in the previous year. I was furthermore unable to perform alternative procedures. Therefore, audit assurance as to the completeness and accuracy of government grants and subsidies revenue as disclosed in note 20 to the financial statements and the completeness and valuation of unspent conditional grants as disclosed in note 15 to the financial statements could not be obtained.

23. In contravention of section 17 of the DoRA and section 8.2 of the MIG policy framework, MIG funds to the value of R2 995 000 were used to pay municipal salaries, other than those of the project management unit, and for the payment of creditors for the month of June 2007. The unspent MIG according to the financial statements exceeded the MIG bank account balance by R3 371 222 in the current year, and the municipal infrastructure grant bank account balance exceeded the unspent MIG according to the financial statements by R4 450 in the previous year. No reasons for non-compliance with grant conditions were disclosed in the financial statements as required by section 123(1)(e) of the MFMA.

Inventory

24. Existence, valuation and completeness of inventory amounting to R4 671 238 in the current year and R3 757 826 in the previous year could not be confirmed and alternative procedures could not be performed due the following:

a) Weaknesses and differences were identified in the physical verification of inventory by the municipality. Furthermore, inventory as disclosed in note 4 to the financial statements exceeded the balance of the inventory listings by R460 126 in the current year. Sufficient appropriate audit evidence could therefore not be obtained as to the existence, completeness and valuation of inventory. This matter was also reported in the previous year.

b) No proof of authorisation could be presented for inventory journals amounting to R209 899 in the previous year and no supporting documentation could be presented for journals amounting to R459 398 relating to inventory in the previous year.

25. Paragraph 7 of the Statement of Generally Accepted Municipal Accounting Practice (GAMAP 12) *Inventories* states that inventory shall be measured at the lower of cost or net realisable value. The municipality did not consider the net realisable value of inventory in arriving at the year-end balance as disclosed in note 4 to the financial statements. The financial impact of this misstatement of inventory, as disclosed in note 2 to the financial statements could not be determined owing to a lack of information concerning the net realisable values. This matter was also reported in the previous year.

Irregular expenditure

26. Section 1 of the MFMA defines irregular expenditure as expenditure incurred by a municipality in contravention of, or not in accordance with, a requirement of the supply chain management policy of the municipality or any of the municipality's by-laws giving effect to such policy, and which had not been condoned in terms of such policy or by-law. Payments amounting to R1 822 304 in the current year and R605 334 in the previous year were identified which did not comply with the requirements of the municipality's supply chain management policy. These irregular expenditures were also not disclosed in the financial statements as required by section 125(2)(d)(i) of the MFMA. This matter was also reported in the previous year.

Fruitless and wasteful expenditure

27. Section 1 of the MFMA defines fruitless and wasteful expenditure as expenditure that was made in vain and would have been avoided had reasonable care been exercised.

Payments amounting to R8 767 681 were identified relating to a tourism event held, which were considered to have been made in vain. This fruitless and wasteful expenditure was not disclosed in the financial statements as required by section 125(2)(d)(i) of the MFMA.

28. Cases of fruitless and wasteful expenditure relating to prior years were identified and disclosed in the Majavu report. The original copies of the supporting documentation for these payments amounting to R677 673 had been removed from the municipality safe. Supporting documentation could still not be presented for these payments. These fruitless and wasteful expenditures were also not disclosed in the financial statements as required by section 125(2)(d)(i) of the MFMA. This matter was also reported in the previous year.

Unauthorised expenditure

29. Section 1 of the MFMA defines unauthorised expenditure as any expenditure incurred by a municipality otherwise than in accordance with section 15 or 11(3) of the act, and includes overspending of the total amount appropriated in the municipality's approved budget. As indicated in appendix C to the financial statements, a net saving of R820 983 was realised on the expenditure budget. However, as mentioned in the receivables and payables paragraphs above, expenditure amounting to R153 940 and R4 330 563 was included in unallocated amounts as disclosed in note 6 and note 14 to the financial statements, respectively. Unauthorised expenditure is therefore understated by at least R3 663 520. The budget of the municipality is not compliant with Standards of Generally Accepted Municipal Accounting Practices and therefore the total unauthorised expenditure incurred could not be determined and alternative procedures could also not be performed. Therefore, the disclosure of unauthorised expenditure was understated by an unknown amount.

Capital commitments

30. Projects amounting to R37 948 560 identified on the *Service Delivery and Budget Implementation Plan* were not considered in determining the capital commitment balance at year-end. Expenditure incurred on these projects could not be determined. In addition, only projects that commenced in the current financial year were taken into consideration in determining the commitment balance and therefore no disclosures of projects running for longer than one year was made. This register was also used to calculate the capital commitments amounting to R1 391 551 for the previous year. I was unable to perform alternative procedures and no assurance could therefore be obtained that capital commitments amounting to R3 346 064 for the current year and R1 391 551 for the previous year were completely and accurately disclosed in note 30 to the financial statements.

Cash flow statement

31. Paragraph 13 of the statement of Generally Recognised Accounting Practice (GRAP 2) *Cash flow statements* states that the separate disclosure of cash flows arising from investment activities is important because the cash flows represent the extent to which cash outflows have been made for resources which are intended to contribute to the entity's future service delivery. The sum of the cash flows from operating, investment and financing activities exceeds the net decrease in cash and cash equivalents of the comparative cash flow statement by R9 228 953. In addition, the net cash flow from investment activities is understated by R20 806 248. Not all figures for the year ended 30 June 2006 were disclosed in the cash flow statement presented in the previous year's financial statements. Therefore, certain comparative cash flow line items, as presented in the cash flow statements and note 28 to the financial statements, could not be recalculated. I was furthermore unable to perform alternative procedures. The net cash flows as disclosed in the comparative cash flow statement are therefore not accurate and

complete. The impact of this matter could not be determined. This matter was also reported in the previous year.

Financial instruments

32. The financial instruments were not disclosed in terms of the South African Statements of Generally Accepted Accounting Practice, IAS 32 (AC 125) *Financial instruments presentation*, which requires detailed financial risk analysis and disclosure.

Disclosure of implementation plan of accounting standards

33. Paragraph 2(3)(e)(ii-iv) of *General Notice 522 of 2007, Government Gazette No.30013 of 29 June 2007* states that the notes to the annual financial statements of high-capacity municipalities must disclose the progress made towards achieving full compliance with the standards referred to in section 122(2), as measured against the implementation plan referred to in paragraph (d), an explanation of the extent to which information in the annual financial statements would need to be adjusted for full compliance with those standards and any relevant information concerning the exemptions that may enhance the usefulness of the annual financial statements. The implementation plan for applying the exemptions was not included in the financial statements.

Disclaimer of opinion

34. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Moqhaka Local Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

35. I draw attention to the following matters:

Going concern

36. The municipality experienced serious difficulties regarding debt collection and there were not sufficient resources to deal with disconnections. The debt collection period was significantly higher than the industry norm for other municipalities. The current and liquidity ratios have decreased compared to the previous year and the municipality might not be in the position to meet its current obligations in the normal course of business. There was a significant increase in the bank overdraft. The MIG was utilised to pay municipal salaries, other than those of the project management unit, and the suppliers for the month of June 2007. It was further noted that the cash disbursements significantly exceeded cash received for months after year-end. The municipality was significantly dependent on the national and provincial government for its continued sustainability. This, along with other matters, points to the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern. The municipality may therefore be unable to realise its assets and discharge its liabilities in the normal course of business. These are indicators that the municipality may possibly be facing serious financial problems in terms of section 138 of the MFMA. The financial statements did not disclose these facts. This matter was also reported in the previous year.

Highlighting critically important matters presented or disclosed in the financial statements

37. As disclosed in note 27 to the financial statements, the municipality did not record all prior period errors in line with the exemptions granted in terms of *General Notice 522 of 2007* issued in *Government Gazette No. 30013 of 29 June 2007.*

Irregular expenditure

38. As disclosed in note 36 to the financial statements, irregular expenditure amounting to R5 028 652 in the current year and R2 408 031 in the previous year was incurred as the proper supply chain management processes had not been followed.

Fruitless and wasteful expenditure

39. As disclosed in note 37 to the financial statements, fruitless and wasteful expenditure amounting to R859 838 was incurred in previous years. These items were identified during a special investigation that was initiated by the council.

OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

Internal controls

40. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Net assets		X	X		
Property, plant and Equipment	X				
Employee-related costs		X	X		
Receivables		X	X		
Revenue		X	X		
Payables		X	X		
Expenditure		X	X		
Value-added tax		X	X		
Unspent conditional grants and receipts		X	X		
Inventory		X	X		
Irregular, fruitless and wasteful expenditure		X	X		
Capital commitments		X	X		
Financial statements		X	X		

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allow people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

Non-compliance with applicable legislation

41. Municipal Finance Management Act, 2003

a) Section 125(2)(e) of the MFMA states that the notes to the annual financial statements of a municipality or municipal entity must disclose particulars of non-compliance with this act. Several instances of non-compliance with the MFMA were noted, none of which were disclosed in the notes to the financial statements.

b) Revenue was not reconciled on a weekly basis as required by section 64 of the MFMA.

c) Creditor statements to the value of R335 061 in the current year and R5 029 110 in the previous year were not paid within 30 days as required by section 65(2)(e) of the MFMA.

d) There was a lack of controls existed over the safeguarding and tracking of important tender documents such as original, signed tender agreements in the previous year. Compliance with the provisions of section 116 of the MFMA could therefore not be confirmed.

e) The municipality did not table the annual report within seven months as required by section 127(2) of the MFMA. In addition, no written explanation setting out the reasons for the delay was submitted to council as required by section 127(3) of the MFMA.

42. Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA)

a) I could not confirm if the municipality certified to the National Treasury that it exclusively appropriated each programme funded or partially funded by this allocation in its annual budget, as required by section 11(2)(a) of the DoRA.

b) I could not confirmed if the municipality, within two months after the end of the financial year, evaluated its performance in respect of programmes funded or partially funded by an allocation and had submitted such evaluations to the transferring national officer as required by sections 11(5) and 12(6) of the DoRA.

Matters of governance

43. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
Audit committee		
• The municipality had an audit committee in operation throughout the financial year.	X	
• The audit committee operates in accordance with approved, written terms of reference.	X	
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
Internal audit		
• The municipality had an internal audit function in operation throughout the financial year.		X
• The internal audit function operates in terms of an approved internal audit plan.		X
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		X
Other matters of governance		
• The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.	X	
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		X
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		X
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		X

Matter of governance	Yes	No
• The prior year's external audit recommendations have been substantially implemented.		X
• The Provincial SCOPA resolutions have been substantially implemented.		X
Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
• The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.		X
• The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.		X
• The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.	X	

Unaudited supplementary schedules

44. Appendices A to D set out on pages X to X did not form part of the financial statements and were presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

45. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

46. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

47. I conducted my engagement in accordance with section 13 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) read with *General Notice 616 of 2007*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

48. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

49. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Non-compliance with regulatory requirements

50. **No reporting on performance information**

The annual performance report of the municipality prepared in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA was not submitted for audit purposes.

51. Content of the integrated development plan

The municipality did not set appropriate key performance indicators as a yardstick for measuring performance, including outcomes and impact, with regard to the municipality's development priorities and objectives set out in its integrated development plan as required by section 41(1)(a) of the MSA.

52. Content of the annual budget

The annual budget for the financial year ended 30 June 2008 was not based on the development priorities and objectives referred to in section 26(c) of the MSA and measurable performance targets were not set by the municipality as required by regulation 6 of the *Municipal Planning and Performance Management Regulations, 2001.*

53. No quarterly reporting on performance information

No quarterly reports on progress made in achieving measurable objectives and targets were prepared by the different programme managers and as a whole for the municipality to facilitate effective performance monitoring, evaluation and corrective action.

54. Functioning of the performance audit committee

Evidence that the audit committee reviewed the performance management system and made recommendations in this regard to council in terms of regulation 14 of the *Municipal Planning and Performance Management Regulations* could not be obtained.

APPRECIATION

55. The assistance rendered by the staff of Moqhaka Local Municipality during the audit is sincerely appreciated.

Auditor-General
Bloemfontein

30 November 2008

AUDITOR-GENERAL